Unit-9 Banking and Financial Institution-II

1. *Financial Markets*

According to the **structural approach,** the financial system of an economy consists of three main components :

- Financial markets;
- Financial intermediaries (institutions);
- Financial regulators

A financial market is a market in which people trade financial securities, commodities, and value at low transaction costs and at prices that reflect supply and demand. It is a broad term describing any marketplace where trading of securities including equities, bonds, currencies and derivatives occurs.

> *According to the **functional approach, financial markets** facilitate the flow of funds in order to finance investments by corporations, governments and individuals. **Financial institutions** are the key players in the financial markets as they perform the function of intermediation and determine the flow of funds. The **financial regulators** perform the role of monitoring and regulating the participants in the financial system.*

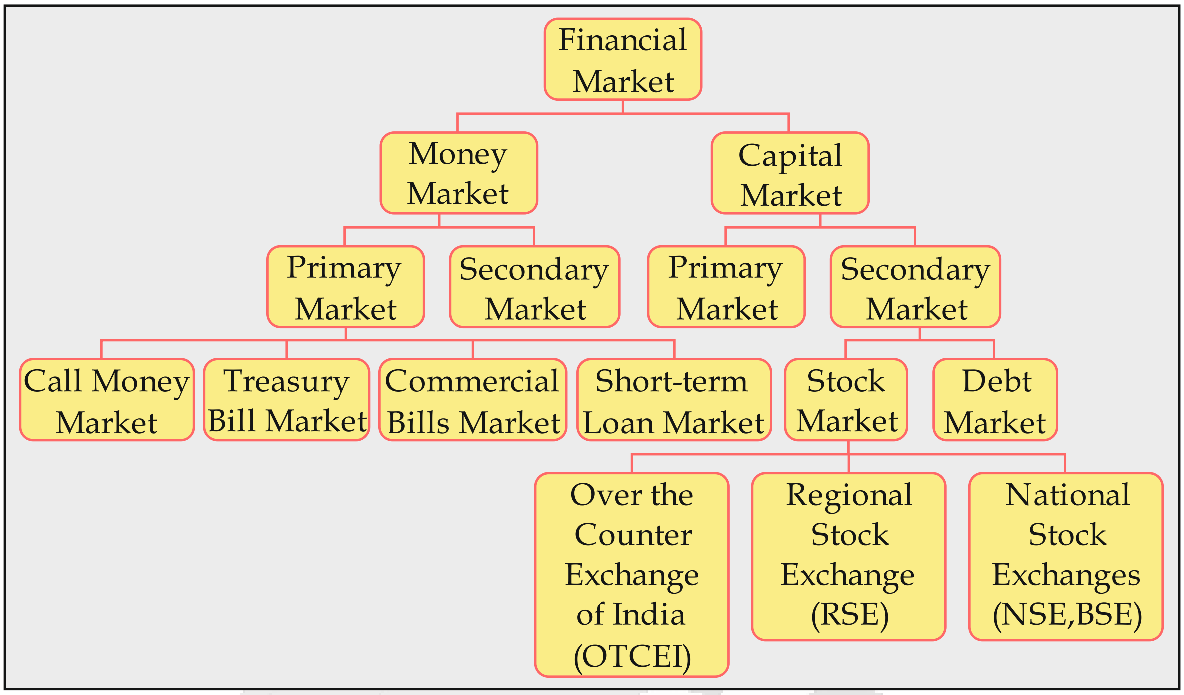
Financial Market refers to a marketplace, where creation and trading of financial assets, such as shares, debentures, bonds, derivatives, currencies, etc. take place. It plays a crucial role in allocating limited resources, in the country's economy. It acts as an intermediary between the savers and investors by mobilising funds between them.

The financial market provides a platform to the buyers and sellers, to meet, for trading assets at a price determined by the demand and supply forces.

Functions of Financial Market

1. It facilitates mobilisation of savings and puts it to the most productive uses.
2. It helps in determining the price of the securities. The frequent interaction between investors helps in fixing the price of securities, on the basis of their demand and supply in the market.
3. It provides liquidity to tradable assets, by facilitating the exchange, as the investors can readily sell their securities and convert assets into cash.
4. It saves the time, money and efforts of the parties, as they don't have to waste resources to find probable buyers or sellers of securities. Further, it reduces cost by providing valuable information, regarding the securities traded in the financial market.

Types of Financial Markets



1.1 Money Market

The term "money market" refers to the network of corporations, financial institutions, investors and governments which deal with the flow of short-term capital. Money market instruments are generally financial claims that have low default risk, maturities under one year and high marketability. **The New York, London, and Tokyo money markets are among the world's largest Money Market.**

Money market securities consist of negotiable **certificates of deposit** (CDs), banker's acceptances, U.S. Treasury bills, commercial paper, municipal notes, euro dollars, federal funds and repurchase agreements (repos). Money market investments are also called cash **investments because** of their short maturities.

Money Market Instruments

The Reserve Bank of India (RBI) plays a key role of regulator and controller of money market. The intervention of RBI is varied – curbing crisis situations by reducing key policy rates or curbing inflationary situations by rising key policy rates such as Repo, Reverse Repo, and CRR etc.

1. **Treasury Bills (T-Bills) :** Treasury Bills are one of the safest money market instruments as they are issued by Central Government. They are zero-risk instruments, and returns are not that attractive. T-Bills are circulated by both primary as well as the secondary markets. They come with the maturities of 3-month, 6-month and 1-year.
2. **Commercial Paper :** Commercial paper is a short-term debt obligation of a private-sector firm or a government-sponsored corporation. In most cases, the paper has a lifetime, or maturity, greater than 90 days but less than nine months. It is the short term unsecured promissory note issued by corporates and financial institutions at a discounted value on face value.

Commercial Paper introduced in india in January 1990. The return on commercial papers is higher as compared to T-Bills so as the risk as they are less secure in comparison to these bills. It is easy to find buyers for the firms with high credit ratings. These securities are actively traded in secondary market.

3. **Bankers' Acceptances :** Before the 1980s, bankers' acceptances were the main way for firms to raise short-term funds in the money markets. An acceptance is a promissory note issued by a non financial firm to a bank in return for a loan.

   The bank resells the note in the money market at a discount and guarantees payment. Acceptance usually have a maturity of less than six months.

   Bankers' acceptance differ from commercial paper in significant ways. The bank guarantees that the buyer will pay the seller on a particular future date. Firm with strong credit rating can draw such bill. These securities come with the maturities between 30 and 180 days and the most common term for these instruments is 90 days. Companies use these negotiable time drafts to finance imports, exports and other trade.

4. **Government Agency Notes :** National government agencies and government-sponsored corporations are heavy borrowers in the money markets in many countries. These include entities such as development banks, housing finance corporations, education lending agencies and agricultural finance agencies.

   Some Govt. agencies issue both short-term and long-term obligations. These obligations are not generally backed by the government, so they offer a slightly higher yield than T-bills, but the risk of default is still very small. Agency securities are actively traded, but are not quite as marketable as T-bills. Corporations are major purchasers of this type of money market instrument.

5. **Local Government Notes :** Local government notes are issued by state, provincial or local governments, and by agencies of these governments such as schools authorities and transport commissions. The ability of governments at this level to issue money-market securities varies greatly from country to country.

   In some cases, the approval of national authorities is required; in others, local agencies are allowed to borrow only from banks and cannot enter the money markets.

6. **Time Deposits :** Time deposits, another name for certificates of deposit or cd's, are interest-bearing bank deposits that cannot be withdrawn without penalty before a specified date. Although time deposits may last for as long as five years, those with terms of less than one year compete with other money-market instruments. Deposits with terms as brief as 30 days are common. Large time deposits are often used by corporations, governments and money-market funds to invest cash for brief periods.

7. **Repurchase Agreements :** Repurchase agreements-also known as repos or buybacks-are Treasury securities that are purchased from a dealer with the agreement that they will be sold back on a future date for a higher price. These agreements are the most liquid of all money market investments, ranging from 24 hours to several months. In fact, they are very similar to bank deposit accounts, and many corporations arrange for their banks to transfer excess cash to such funds automatically.

8. **International Agency Paper :** International agency paper is issued by the World Bank, the Inter- American Development Bank and other organizations owned by member governments. These organizations often borrow many different currencies, depending upon interest and exchange rates.

9. **Promissory Note :** The promissory note is the earliest type of bill. It is a written promise on the part of a businessman today to another a certain sum of money at an agreed future data. Usually, a promissory note falls due for payment after 90 days with three days of grace. A promissory note is drawn by the debtor and has to be accepted by the bank in which the debtor has his account, to be valid. The creditor can get it discounted from his bank till the date of recovery. Promissory notes are rarely used in business these days, except in the USA.

10. **Bill of Exchange or Commercial Bills :** Another instrument of the money market is the bill of exchange which is similar to the promissory note, except that it is drawn by the creditor and is accepted by the bank of the debater. The creditor can discount the bill of exchange either with a broker or a bank. There is also the foreign bill of exchange which becomes due for payment from the date of acceptance. The rest of the procedure is the same as for the internal bill of exchange. Promissory notes and bills of exchange are known as trade bills.

11. **Call and Notice Money:** There is the call money market in which funds are borrowed and lent for one day. In the notice market, they are borrowed and lent upto 14 days without any collateral security. But deposit receipt is issued to the lender by the borrower who repays the borrowed amount with interest on call. In India, commercial banks and cooperative banks borrow and lend funds in this market but mutual funds and all-India financial institutions participate only as lenders of funds.

12. **Inter-bank Term Market :** This market is exclusively for commercial and cooperative banks in India, which borrow and lend funds for a period of over 14 days and upto 90 days without any collateral security at market-determined rates.

13. **Certificates of Deposits (CD) :** Certificates of deposits are issued by commercial banks at a discount on face value. The discount rate is determined by the market. In India the minimum size of the issue is Rs. 25 lakhs with the minimum subscription of Rs. 5 lakhs. The maturity period is between 3 months and 12 months.

14. **Repurchase Agreements (Repo) :** Repurchase Agreements, also known as Reverse Repo or simply as Repo, loans of a short duration which are agreed upon by buyers and sellers for the purpose of selling and repurchasing. These transactions can only be carried out between RBI approved parties.Repo/Reverse Repo transactions can be done only between the parties approved by RBI. Transactions are only permitted between securities approved by the RBI like treasury bills, central or state government securities, corporate bonds and PSU bonds.

1.2 Capital Market

Capital markets are the markets for intermediate- or long-term debt and corporate stocks. Here "long-term" refers to a financial instrument with an original maturity greater than one year and perpetual securities (those with no maturity). Capital Market is a wide term.

Securities market is a component of the wider financial Market where Securities can be bought and sold between subjects of the economy, on the basis of demand and supply. Securities markets encompasses equity Markets, bond Markets and derivatives Market where price can be determined and the participants, both professional and non-professionals can meet.

There are two types of capital market securities : those that represent shares of ownership interest, also called **equity**, issued by corporations, and those that represent indebtedness, or **debt** issued by corporations and by the state and local governments.

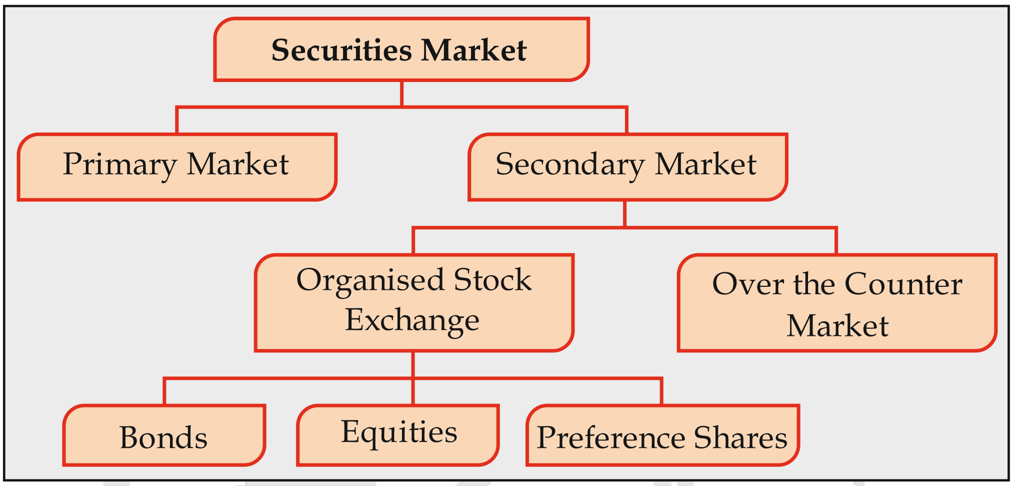


Fig. : Securities Market

(A) Primary Market

Primary markets are the markets in which corporations raise new capital. If Company sells a new issue of common stock to raise capital, this would be a primary market transaction. Primary market issues new securities on an exchange for companies, governments and other groups to obtain financing through debt-based or equity-based securities.

Features of Primary Market

- It is the new issue market for the new long term capital.
- Here the securities are issued by company directly to the investors and not through any intermediaries.
- On receiving the money from the new issues, the company will issue the security certificates to the investors.
- The amount obtained by the company after the new issues are utilized for expansion of the present business or for setting up new ventures.
- External finance for longer term such as loans from financial institutions is not included in primary market. There is an option called 'going public' in which the borrowers in new issue market raise capital for converting private capital into public capital.

Types of Primary Issue

Public issues can be classified into 3 types :

(a) **Initial Public Offering (IPO) :** Fresh issue of shares or selling existing securities by an unlisted company for the first time is known as IPO. Listing and trading of securities of a company takes place in IPO.

(b) **Rights Issue :** Rights issue is when the listed company issues new securities and provides special rights to its existing shareholders for buying the securities before issuing it to public. The rights are issued on particular ratio based on the number of securities currently held by the shareholder.

(c) **Preferential Issue :** It is the fresh issue of securities and shares by listed company. It is called as preferential as the shareholders with preferential shares get the preference when it comes to dividend disbursement.

(d) **Private Placement :** An unlisted company which wants to raise equity funds but is not yet prepared to make an IPO may place privately its equity or equity related instruments with one or more sophisticated investors such as financial institutions, mutual funds, venture capital funds, banks etc.

The private placements can be made by a company to the investors at any agreed price and quantity as such private equity issues are not regulated by SEBI. The Securities and Exchange Board of India (SEBI) has effected several reforms in the New Issue Market. These reforms seek improved disclosure standards, prudential norms and simplification of issue procedures.

(B) Secondary Market

It is a Market for trading and settlement of securities that have already been issued. The Secondary Market deals with the purchase and sale of old securities, the firms issuing new securities get themselves registered on a Stock Exchange by applying for listing of shares. Listing offers the investor a 'market' for the sale of his stock. Equity shares, bonds, preference shares, treasury bills, debentures, etc. are some of the key products available in a secondary market.

Since 1995 trading in securities is screen based and Internet based trading is also made an appearance in India.

The Secondary Market of Securities in India functions through its following two segments:

(1) Stock Exchange;

(2) Over-the-Counter Market.

(1) Stock Exchange : Stock Exchange is an organized market for the purchase and sale of secondhand listed industrials and financial {i.e., shares and debentures of corporate companies). Listed securities are those securities which appear on the approved list of a Stock Exchange.

Only listed securities are traded on the floor of the Stock Exchange. It is to be noted that an organized Stock Exchange is an 'auction' type of market, where the prices of traded securities are settled by open bids and offers on the floor of the exchange.

In a Stock Exchange, the transactions in stocks can be classified into two types :

(a) Investment transactions; and

(b) Speculative transactions.

(a) Investment Transactions : An investment transaction in securities is that transaction which is concerned with the purchase of securities, with a view to investing funds to get an income as annual dividends from these securities and gain from the sale of these securities.

The basic feature of an investment transaction is that it involves the actual delivery of the security and payment of its full price. An investment transaction is motivated by the considerations of safety of investment and security of income.

(b) Speculative Transactions : The speculative transaction in securities is that transaction which is concerned with the purchase or sale of securities for the sake of capital appreciation. The basic feature of a speculative transaction is that the delivery of securities or the payment of the full price is rare.

The speculator neither takes delivery of the securities sold instead he only receives or pays the difference between the purchase and sale prices, as the case may be. The trading in securities, without the intention of taking delivery or making payment, is called forward trading.

Under the Securities Contract (Regulation) Act. 1956 forward trading was perfectly legal till it was suspended in 1969 along with all the regulatory and penal measures.

The suspension of forward trading created a real vacuum in the stock market. The stock brokers devised the extra-legal **Badla** system to fill up this vacuum.

Under this Badla system, securities contract was turned into a carry-forward instrument merely by closing the contract on the 14th day and replacing it by a new hand-delivery contract between the same buyer and seller in respect of the same securities.

Only the difference between the 'contract price' and the 'market price' would change hands between the buyer and the seller. Badla transactions became the predominant form of Stock Exchange transactions. Since real transactions involving the transfer of securities became a microscopic minority, serious problem of excessive speculation developed in the stock market. In short, the Badla system led to excessive speculation and short-selling often amounting to gambling.

The Securities and Exchange Board of India (SEBI) banned the Badla system in December 1993. There was an increasing demand for the legitimate forward trading to give boost to the stock market. Since stock market quotations are often considered as the barometers of a country's economy, the SEBI and the Government should stimulate stock market. The SEBI, therefore, reintroduced Badla (forward trading) on July 27, 1995. Now, with the introduction of derivatives in stock market the same purpose is served by the derivatives called futures as the old Badla system.

(2) Over-the-Counter Market : *The first electronic OTC stock exchange in India was established in 1990 to provide investors and companies with an additional way to trade and issue securities.* This was the first exchange in India to introduce market makers, which are firms that hold shares in companies and facilitate the trading of securities by buying and selling from other participants.

An over-the-counter contract is a bi-lateral contract, in which two parties agree on how a particular trade or agreement is to be settled in the future. For derivatives, these agreements are usually governed by an International Swaps and Derivatives Association agreement.

The **over-the-counter (OTC) market,** also known as the **over-the-counter bulletin board (OTCBB)**, is a quotation service offered by the National Association of Securities Dealers (NASD) that provides quote and volume information for securities traded over the counter (that is, securities not listed on the Nasdaq, NYSE, AMEX or other exchanges).

Businesses that cannot get listed on a stock exchange are still able to sell stock in their companies by trading shares privately, referred to as trading "over the counter." Trade bonds, derivatives and commodities on the OTC market. OTC trades occur via telephone, email, and fax or in person between private individuals, with no central exchange location for all traders.

OTC trading is to trade financial instruments such as stocks, bonds, commodities or derivatives directly between two parties. It is the opposite of exchange trading which occurs on futures exchanges or stock exchanges.

In the OTC market, trading occurs via a network of middlemen, called dealers, who carry inventories of securities to facilitate the buy and sell orders of investors, rather than providing the order matchmaking service seen in specialist exchanges.

Stock Exchange

The Securities Contract (Regulation) Act, 1956 (SCRA) define "Stock Exchange as anybody of individuals, whether incorporated or not constituted for the purpose of assisting, regulating or controlling the business of buying, selling or dealing in securities".

DID YOU KNOW ?

The first stock exchange was opened in Amsterdam in 1602. The three largest exchanges in the world are (in the descending order) New York Stock Exchange (NYSE), NASDAQ United States and the Tokyo Stock Exchange (TSE). Bombay stock Exchange (BSE) is the 10^{th} largest stock exchange in the world.

Stock exchanges basically serve as :

(1) Primary markets where corporations, governments, municipalities, and other incorporated bodies can raise capital by channeling savings of the investors into productive ventures; and

(2) Secondary markets where investors can sell their securities to other investors for cash, thus reducing the risk of investment and maintaining liquidity in the system. Stock exchanges impose stringent rules, listing requirements, and statutory requirements that are binding on all listed and trading parties.

Characteristics of Stock Exchange

The stock exchange is an organized market for the purchase and sale of listed securities. They facilitate, regulate and control the trade in securities. The following are the features of stock markets :

Characteristics of Stock Exchange

1. Association

2. Mechanism

3. Organized Market

4. Market for Old Securities

5. Deals with Listed Securities

6. Only The Members Allowed Dealing

7. It Also Deals in Government Securities

8. Ensures Free Transferability of Securities and Securities Evaluation

(1) **Association :** Stock market is an association of persons that may be incorporated or not.

(2) **Mechanism :** It provides a place or mechanism through which industrial and government securities may be bought and sold.

(3) **Organized Market :** It is an organized market for securities. It allows trading in securities subject to certain regulations.

(4) **Market for Old Securities :** It provides the ready market for old securities that have been already issued by the companies to public. It does not deal in the fresh shares, debentures and bonds to be issued by the companies or government agencies to the public. In stock market transactions in old securities of companies are carried on without the involvement of companies.

(5) **Deals with Listed Securities :** It offers trading facilities only for those securities that are listed by the companies or issuing agencies with the exchange. If a company has not complied with the listing procedure of a stock market then its securities are not allowed to be traded on such stock market.

(6) **Only The Members Allowed Dealing :** These stock markets allow only their members to transact the business in the market. Outsiders or nonmembers cannot purchase or sale the securities on these stock exchanges. Membership of a particular stock exchange (say Bombay stock Exchange or National stock Exchange or Bangalore Stock Exchange) is acquired by individuals and firms only on payment of the membership fees prescribed by that stock exchange. Such fee is normally very high. Members of a stock exchange are known as brokers. They purchase and sell securities for and on behalf of their clients, buyers and sellers, investors and speculators. For these services they charge fees known as brokerage.

(7) **It also Deals in Government Securities :** An independent section of stock markets deals with government and semi- government securities. It is called gilt edged market and government securities are called gilt edged securities.

(8) **Ensures Free Transferability of Securities and Securities Evaluation :** Stock exchange provides a mechanism for free transfer of industrial securities and also makes continuous evaluation of securities traded in the market.

Functions (Services) of Stock Exchange

Stock exchanges play an important role in the economic development of a nation. They serve as an economic barometer of a country. They perform several economic functions and render invaluable services to the investors, companies and to the economy as a whole.

These are as follows :

Functions (Services) of Stock Exchange

- *Marketability of Securities*
- *Liquidity to Investment*
- *Supply of Long Term Funds*
- *Evaluation of Securities*
- *Motivation for The Companies for Improvement in Performance*
- *Assistance of Capital Formation*
- *Protection of Investors*
- *Encouragement of Savings*
- *Listing of Securities*
- *Maintaining Business Information*

(1) **Marketability of Securities :** Stock exchange provides a market for the purchase and sale of securities. As a result, any person holding securities can get back his money invested in the securities (share, debentures, government bonds etc.) by selling them through the brokers of a stock exchange at the market price. Similarly a person willing to make investment in securities or conduct speculation in securities can do so with the help of these stock markets.

(2) **Liquidity to Investment :** People readily invest in the industrial securities as the money blocked in these securities can be released by selling them in stock exchange. In absence of these stock exchanges, the public would not have freely invested in the industrial and government securities. As a result, the industry and government would have starved for the capital. Thus stock exchanges provide liquidity for the industrial securities and help the industrial development of a country.

(3) **Supply of Long Term Funds :** The securities traded in stock market are negotiable. They can be transferred with minimum formalities from one person to another. As a result of this facility people readily invest in the industrial securities and companies receive a good response for their public issue of shares and debentures whenever they need funds. Thus they are assured a long-term availability of funds due to the existence of stock markets.

(4) **Evaluation of Securities :** Stock exchange keeps a record and makes a public declaration of prices at which securities are traded. On the basis of these prices for the securities quoted in the markets the investors and speculators can evaluate the values of securities held by them.

(5) **Motivation for The Companies for Improvement in Performance :** The performance of a company is reflected through the prices quoted for their securities in the stock markets. With the improvement in the performance of a company the prices of its shares in the market increase enhancing the goodwill of the company. Thus stock markets indirectly motivate the companies to improve their financial performance through continual increase in productivity and profitability.

(6) **Assistance of Capital Formation :** Stock market ensures liquidity of industrial securities; it also ensures the appreciation of funds invested in the securities with the improvement in the performance of companies and increase in the demand for their securities. Thus they motivate the public to invest their savings in the capital of companies. These savings are channelized in the productive activities of the companies resulting in the capital formation which is essential for the economic development of a nation.

(7) **Protection of Investors :** Stock markets conduct the trade in securities subject to certain rules and regulation. These rules prevent overtrading, illegitimate speculations and charging of excess commission on trading by the brokers in order to protect the interest of common investors. Thus stock exchanges safeguard the innocent investors from the malpractices of clever brokers dealing in securities. This strengthens the investors' confidence and promotes large investments.

(8) **Encouragement of Savings :** Stock exchange provides an attractive avenue for investors wherein they can invest their small savings in industrial securities and obtain a regular return on investment as well as capital appreciation. Thus they encourage savings habits among the public.

(9) **Listing of Securities :** Stock exchanges do the listing of securities of various companies. Only listed securities are traded on stock exchanges. Listing of a security means permission to the security to quote officially on trading floor of the stock exchange. Shares or debentures of a particular company can be listed and traded at stock exchange only if the company fulfils certain standard norms fixed by the exchange.

(10) **Maintaining Business Information :** Companies whose securities are listed on stock exchange are required to furnish the financial statements and other reports and statements. The stock exchange maintains a detailed record of the various companies whose securities are traded on its floor. Such information is regularly published and maintained on web site for public reference by the stock exchange.

Stock Exchange in India

The overall responsibility of development, regulation and supervision of the stock market rests with the Securities and Exchange Board of India (SEBI), which was formed in 1992 as an independent authority.

Most of the trading in the Indian stock market takes place on its two stock exchanges :

The Bombay Stock Exchange (BSE) and the National Stock Exchange (NSE).

The BSE has been in existence since 1875. The NSE, on the other hand, was founded in 1992 and started trading in 1994. However, both exchanges follow the same trading mechanism, trading hours, settlement process, etc.

Bombay Stock Exchange (BSE)

The history of BSE can be traced back to 1850s when a group of five stock brokers used to conduct meetings under the banyan tree in front of Mumbai Town Hall. As the number of the brokers increased, they started changing the venue of the meeting constantly. Almost two decades later, this small group moved to the **Dalal Street in 1874,** and later, in the following year, it was recognized as an official organization by the name **'The Native Share and Stock Brokers Association'.**

As per the Securities Contracts Regulation Act, BSE became the **first stock exchange to be recognized by the Government of India in 1956.** BSE Sensex was developed in 1986 which was considered a tool to measure the overall performance of the Bombay Stock Exchange. Using this index, various equity derivative markets were open and many future trading contracts were made in 2000 which further led to expansion of its trading platform. BSE switched to electronic trading system in 1995 and took only fifty days for this transition.

'BOLT' or the 'BSE on Line Trading' is the automated version of the trading platform, which is screen based and currently has a capacity of 8 million orders per day. Also, BSE is the first stock exchange in the world to introduce centralized internet trading system **(BSEWEBx.co.in),** allowing investors from all over the world to trade on the BSE platform. BSE also provides depository services through its **Central Depository Services Ltd. (CDSL).**

NSE (National Stock Exchange)

NSE is recognized as a stock exchange by **SEBI in April 1993 and commenced operations in 1994** with the launch of the wholesale debt market, followed shortly after by the launch of the cash market segment.

The NSE was established in 1992 as the first demutualized electronic exchange in the country. NSE was the first exchange in the country to provide a modern, fully automated **screen-based electronic trading system (SBTS) by VSAT (Very Small Aperture Terminal)** which offers easy trading facility to the investors spread across the length and breadth of the country with high level of information dissemination through on-line system. The NSE trading system called **'National Exchange for Automated Trading' (NEAT).**

Headquartered in Mumbai, NSE offers capital raising abilities for corporations and a trading platform for equities, debt, and derivatives including currencies and mutual fund units. It allows for new listings, initial public offers (IPO), debt issuances and Indian Depository Receipts (IDRs) by overseas companies raising capital in India.

The exchange offers clearing and settlement services through its wholly-owned unit, the National Securities Clearing Corporation Ltd. (NSCCL) set up in 1995. The other main subsidiaries/ associate companies of NSE include the National Commodity Clearing, National Securities Depository (which is the repository of all securities in electronic form), and National Commodity and Derivatives Exchange.

NSE offers trading and investment in the following segments

Equities

- Equities
- Indices
- Mutual Funds
- Exchange Traded Funds
- Initial Public Offerings
- Security Lending and Borrowing Scheme etc.

Derivatives

- Equity Derivatives (including Global Indices like CNX 500, Dow Jones and FTSE)
- Currency Derivatives
- Interest Rate Futures

Debt

- Corporate Bonds

NSE was also instrumental in creating the **National Securities Depository Limited (NSDL)** which allows investors to securely hold and transfer their shares and bonds electronically. It also allows investors to hold and trade in as few as one share or bond. This not only made holding financial instruments convenient but more importantly, eliminated the need for paper certificates and greatly reduced the incidents of forged or fake certificates and fraudulent transactions that had plagued the Indian stock market.

MCX-SX (Metropolitan Stock Exchange of India Ltd.)

Metropolitan Stock Exchange Of India Ltd. was founded in 2008 and it is the youngest exchange in India.

The **Metropolitan Stock Exchange** (MSE) is one of the 8 (eight) Stock exchanges recognized by country's securities market regulator,–Securities and Exchange Board of India (SEBI). It offers an electronic platform for trading in capital market, futures and options, currency derivatives, Interest Rate Futures (IRF) and Debt Market segments. Its current shareholders include Indian public sector banks, private sector banks, investors and domestic financial institutions.

Metropolitan Stock Exchange of India Limited (MSE) is recognized by Securities and Exchange Board of India (SEBI) under Section 4 of Securities Contracts (Regulation) Act, 1956.

The Exchange was notified by a "recognized stock exchange" under Section 2(39) of the Companies Act, 1956 by Ministry of Corporate Affairs, Govt. of India, on December 21, 2012.

Shareholders of the Exchange include public sector banks, private sector banks, domestic financial institutions and marquee investors who, together hold over 88% stake in the Exchange. MSE is subjected to CAG Audit and has an independent professional management.

Inter-Connected Stock Exchange of India Limited (ISE)

Inter-connected Stock Exchange of India Limited (ISE) is a national-level stock exchange, providing trading, clearing, settlement, risk management and surveillance support to its Trading Members.

Inter-connected Stock Exchange Ltd. (ISE) is an Indian national-level Stock Exchange, providing trading, Clearing, Settlement, Risk Management and surveillance support to its trading members. It started its operation in 1998 in Vashi, Mumbai and has 841 trading members, who are located in 18 cities.

These intermediaries are administratively supported through the regional offices at Delhi, Kolkata, Patna, Ahmedabad, Coimbatore and Nagpur besides Mumbai.

Need to Invest in Share Market

(a) **Pan Card :** Permanent Account Number (PAN) is a unique, 10-character alpha-numeric identifier, issued to all judicial entities identifiable under the Indian Income Tax Act, 1961. PAN is however required for opening a bank account, investing in mutual funds, filling Income Tax returns etc. Also the first thing need to be able to invest in shares in India is a PAN card.

(b) **Broker :** Individuals can't directly go the stock exchange and buy or sell stocks/ shares. The people who are authorized to buy and sell in the markets are called brokers. A broker can be an individual or company or even an online agency, registered and licensed by Securities and Exchanges Board of India (SEBI), who regulates the share markets.

(c) **Demat and Trading Account :** A Demat account will hold the stocks or shares in name and the same will reflect in stock portfolio as can't hold or store shares in physical form. Buying and selling shares in the stock market will require a Trading account. It's like an intermediary who facilitates the buying and selling.

(d) **Shares :** A share, also known as equity or stock, is one of a finite number that represents fractional ownership of the corporation in proportion to the total number of shares.

(e) **Depository Participate :** There are two depositories in India : **NSDL** and CDSL which stands for **National Securities Depository Limited and Central Depository Services Limited.** These two have their agents in the form of Depository Participants who will provide an account to store the shares hold. It is not the same as Demat and Trading account as in Demat it shows the number of shares hold and the Trading reflects the buying and selling that has taken place in account. Depository Participants will hold those shares bought and release the shares sold.

DID YOU KNOW ?

Arbitrage - A Business arrangement in which a share broker tries to take advantage of difference in prices between two Stock Exchange centers on a particular share.

Over The Counter Exchange of India (OTCEI)

Over The Counter Exchange of India (OTCEI) can be defined as a stock exchange without a proper trading floor. All stock exchanges have a specific place for trading their securities through counters but the OTCEI is connected through a computer network and the transactions are taking place through computer operations. Thus, the development in information technology has given scope for starting this type of stock exchange.

OTCEI was incorporated in 1990 as a Section 25 company under the Companies Act 1956 and is recognized as a stock exchange under Section 4 of the Securities Contracts Regulation Act, 1956. The Exchange was set up to aid enterprising promoters in raising finance for new projects in a cost effective manner and to provide investors with a transparent and efficient mode of trading.

An electronic stock exchange based in India that is comprised of small- and medium-sized firms looking to gain access to the capital markets. Like electronic exchanges in the U.S. such as the Nasdaq, the areas no central place of exchange and all trading is done through electronic networks.

Special Features of OTCEI :

1. **Use of Modern Technology :** Unlike other stock market, OTCEI does not have any special counters and it is an electronically operated stock exchange.
2. **Restrictions for Other Stocks :** Stocks and shares listed in other stock exchanges will not be listed in the OTCEI and similarly, stocks listed in OTCEI will not be listed in other stock exchanges.
3. **Minimum issued Capital Requirements :** Minimum Paid Up Capital should be Rs. 30 Lakhs, out of which minimum public offer should be 25% of the issued capital or Rs. 20 Lakhs.

4. **Restrictions for Large Companies :** No company with the issued equity share capital of more than Rs. 25 Crores is permitted for listing.
5. **Base Capital Requirement for Members :** Members will be required to maintain a minimum base capital of Rs. 4 Lakhs to trade on the permitted or on listed segment.
6. **All India Network :** The network of counters links OTCEI members, located in different parts of the country.
7. **Satellite Facility :** The satellite required for OTCEI for its operations is jointly held with Press Trust of India (PTI) and PTI-OTCEI scan displays the prices of OTCEI's scripts.
8. **Computerization of Transactions** : Computers at each counter enable dealers to enter various transactions or queries or quotes through a central OTCEI computer, using telecommunications links.

OTCEI was promoted by a consortium of financial institution including :

- Unit Trust of India.
- Industrial Credit and Investment Corporation of India.
- Industrial Development Bank of India.
- Industrial Finance Corporation of India.
- Life Insurance Corporation of India.
- General Insurance Corporation and its subsidiaries.
- SBI Capital Markets Limited.
- Canra bank Financial Services Ltd.

Need for OTCEI

- Hybrid Trading System
- Sponsorship of Companies
- Cost Effective
- Ideal for Start-up Companies
- Enhanced Visibility and Recognition
- Assist in Forging Partnership
- Specialist exchange for technology and growth companies

Benefits of Getting OTCEI Listing for Companies

The OTCEI offers facilities to the companies having a issued equity capital of more than Rs. 30 lakhs. The benefits of listing at the OTCEI are :

- Small and medium closely-held companies can go public
- The OTCEI encourages entrepreneurship
- Companies can get the money before the issue in cases of Bought-out-deals.
- It is more cost-effective to come with an issue of OTCEI.
- Small companies can get listing benefits
- Easy issue marketing by using the nation-wide OTCEI dealer network.
- Nation-wide trading by listing at just one exchange

Trading Mechanism of OTCEI

An investor can buy and sell any listed scrip at any OTC Exchange counter. The investor can also make an application for services like transfer of shares, splitting and consolidation of shares, nomination and revocation of nomination, registering power of attorney etc. The parties involved in trading on OTC are investor, Counter, Settler Registered Custodian, Company a Bank. The trading documents mainly involved in OTC Exchange transactions are :

- Temporary Counter Receipt (TCR)
- Permanent Counter Receipt (PCR)
- Sales Confirmation Slip (SCS)
- Transfer Deed (TD)
- Service Application Form (SAF)
- Application Acknowledgement Slip (AAS)
- Deal Form (DF)

Trading Process on OTCEI

One can trade in securities by going to any counter of the OTCEI. All the counters are linked with the central computer at the OTCEI headquarter. This office is in Mumbai. There can be three types of trading on the OTCEI

(1) Initial Allotment

(2) Buying in Secondary Market

(3) Selling in Secondary Market

(1) **Initial Allotment :** When an investor is allotted shares through the medium of OTCEI, he is given a receipt which is called Counter Receipt - CR. This receipt is just like the share certificate.

(2) **Buying in the Secondary Market :** For the purpose of buying shares listed on the OTCEI, person has to get himself registered (if he is not already registered). After this, he has to inform the counter operator about the number of the shares to be purchased. The counter operator displays the rates on the screen. After getting him-self satisfied with the rate, the investor hands over the cheques to the operator. On the encashment of the cheques, the CR is handed over to the investor. This procedure normally takes about a week.

(3) **Selling in the Secondary Market :** Any investor who has purchased shares from the OTCEI can sell his shares at any counter of the OTCEI. After getting him-self-satisfied with the rate displayed on the screen, the invest or hands over the Counter Receipt and the Transfer Deed to the Operator. The operator prepares the Sales Confirmation Slip (SCS) and a copy of it is handed over to the seller.

The operator sends the CR, TD and SCS to the Registrar for confirmation. After confirming every detail the Registrar sends them back to the counter operator. In the end the operator issues a cheques to the seller and receives back the SCS from the seller.

OTC has a unique feature of trading compared to other traditional exchanges. That is certificates of listed securities and initiated debentures are not traded at OTC. The original certificate will be safely with the custodian. But, a counter receipt is generated out at the counter which substitutes the share certificate and is used for all transactions.

In the case of permitted securities, the system is similar to a traditional stock exchange. The difference is that the delivery and payment procedure will be completed within 14 days. Compared to the traditional Exchanges, OTC Exchange network has the following advantages:

1. OTCEI has widely dispersed trading mechanism across the country which provides greater liquidity and lesser risk of intermediary charges.
2. Greater transparency and accuracy of prices is obtained due to the screen-based scrip less trading
3. Since the exact price of the transaction is shown on the computer screen, the investor gets to know the exact price at which is trading.
4. Faster settlement and transfer process compared to other exchanges. In the case of an OTC issue (new issue), the allotment procedure is completed in a month and trading commences after a month of the issue closure, whereas it takes a longer period for the same with respect to other exchanges. Thus, with the superior trading mechanism coupled with information transparency investors are gradually becoming aware of the manifold advantages of the OTCEI.

Following are the securities that are traded on the OTCEI :

1. **Listed Equity (Exclusive) :** These are equity shares of the companies listed exclusively on the OTCEI. The share can be bought or sold at any of the member/dealer's office all over India.

   The securities, which are listed exclusively on the OTCEI, cannot be traded on other stock exchanges.
2. **Listed Debt :** These are the debentures/bonds that are issued through a public issue or a private placement and are listed on OTCEI. Any entity holding the entire series of a particular debt instrument can also offer them for trading on the OTCEI, by appointing an OTCEI member/dealer to carry out compulsory market making in those securities.
3. **Gilts :** The securities issued by the Central and State Governments are called 'gilts'. Government of India Dated Securities, Treasury Bills and special securities are traded in this segment. Banks, Foreign Investors, Foreign Institutional Investors, NBFCs and Provident Funds can trade in these securities through OTCEI designated members/dealers.. PSU Bonds, Commercial Paper, and Certificates of Deposit will also be traded in this segment.
4. **Permitted Securities :** These are the securities listed on other exchanges, which are permitted for trading on OTCEI. Securities of Blue Chip companies like ACC, Reliance Industries Ltd., State Bank of India, ITC, etc. are traded in this segment.
5. **Listed Mutual Funds :** Listed mutual funds are units of mutual funds that are listed on OTCEI.

NASDAQ (National Association of Securities Dealers Automated Quotations)

A computerized system established by the NASD to facilitate Trading by Providing broker/dealers with current bid and ask price quotes on over the counter stocks and some listed stocks. Unlike the Amex and the NYSE, the Nasdaq (once an acronym for the **National Association of Securities Dealers Automated Quotation system)** does not have a physical Trading Floor that brings buyers and sellers together. Instead, all trading on the Nasdaq exchange is done over a network of computers and telephones.

Nasdaq Stock Market began trading on **February 8, 1971.** It was the world's first electronic stock market. At first, it was merely a **quotation system** and did not provide a way to perform electronic trades. The Nasdaq Stock Market helpeed to lower the spread (the difference between the bid price and the ask price of the stock) but was unpopular among brokerages which made much of their money on the spread.

Headquartered in **New York,** Nasdaq OMX operates 26 markets – primarily equities, and also including options, fixed income, derivatives and commodities – as well as three clearinghouses and five central securities depositories in the U.S. and Europe. Its cutting-edge trading technology is used by 70 exchanges in 50 countries.

The Nasdaq Stock Market eventually assumed the majority of major trades that had been executed by the **Over the counter (OTC) system** of trading, although there are still many securities traded in this fashion. As **late as 1987, the NASDAQ** exchange was still commonly referred to as "OTC" in media and also in the monthly Stock Guides (stock guides and procedures) issued by **Standard and Poor's Corporation.**

Historical Event of NASDAQ

1971 : NASDAQ introduces the era of all-electronic trading. With this innovation, NASDAQ attracts new growth companies, such as Microsoft, Apple, Cisco, Oracle and Dell.

1987 : Europe's first derivatives exchange (founded in 1985) becomes the world's first exchange that is publicly traded and listed.

1990 : The first exchange in history to transform the exchange business model by leveraging its capital markets and technology expertise to service the exchange industry. The company sold the world's first electronic exchange system for derivatives trading, commercializing its proprietary technology.

2005 : NASDAQ begins offering investor relations, public relations and multimedia services (technology-based monitoring, reporting and marketing) to listed companies to help, promote their capital health. Today, this business represents more than 10% of total net revenue.

2007 : NASDAQ merges with OMX, a leading exchange operator in the Nordics, to diversify and expand its global footprint, and changes its name to The NASDAQ OMX Group.

2014 : The NASDAQ OMX Group is now known as NASDAQ, which represents its rising global brand recognition and new brand identity.

2016 : International Securities Exchange (ISE) is acquired by Nasdaq, a move that strengthens the company as a premier options exchange operator.

2017 : NASDAQ announces Nasdaq ventures, a program dedicated to discovering, investing in and partnering with unique finch companies to enhance its technology and benefit clients.

Derivatives and Option

Derivative is a product whose value is derived from the value of one or more basic variables, called bases (underlying asset, index, or reference rate), in a contractual manner. The underlying asset can be equity, forex, commodity or any other asset. For example, wheat farmers may wish to sell their harvest at a future date to eliminate the risk of a change in prices by that date. Such a transaction is an example of a derivative. The price of this derivative is driven by the spot price of wheat which is the "underlying".

In the Indian context the Securities Contracts (Regulation) Act, 1956 (SCRA) defines "derivative" which includes :

- A security derived from a debt instrument, share, loan whether secured or unsecured, risk instrument or contract for differences or any other form of security.
- A contract which derives its value from the prices, or index of prices, of underlying securities.

> *"A derivative can be defined as a financial instrument whose value depends on (or derives from) the values of other, more basic underlying variables."* **- John C. Hull**

Derivatives trading commenced in India in **June 2000** after SEBI granted the final approval to this effect in May 2001. SEBI permitted derivative segments of two stock exchanges, NSE and BSE, and their clearing house/corporations to commence trading and settlement in derivative contracts. SEBI approved trading in index futures contracts based on S and P CNX Nifty and BSE-30 (Sensex) index. This was followed by approval for trading in options based on these two indexes and option on individual securities.

Types of Derivatives

The most commonly used derivatives contracts are forwards, futures and options.

(A) Forwards : A forward contract is a customized contract between two entities, where settlement takes place on a specific date in the future at today's pre-agreed price.

> *"A contract that commits one party to buy and other to sell a given quantity of an asset for fixed price on specified future date".*

In Forward Contracts one of the parties assumes a long position and agrees to buy the underlying asset at a certain future date for a certain price. The specified price is called the delivery price. The contract terms like delivery price, quantity are mutually agreed upon by the parties to contract. No margins are generally payable by any of the parties to the other.

Features of Forward Contract

- It is negotiated contract between two parties i.e. Forward contract being a bilateral contracts, hence exposed to counterparty risk.
- Each Contract is custom designed and hence unique in terms of contract size, expiration date, asset quality, asset type etc.
- A contract has to be settled in delivery or cash on expiration date.
- In case one of two parties wishes to reverse a contract then he has to compulsorily go to the other party. The counter party being in a monopoly situation can command at the price wants.

(B) Futures : A futures contract is an agreement between two parties to buy or sell an asset at a certain time in the future at a certain price. Futures contracts are special types of forward contracts in the sense that the former are standardized exchange traded contracts.

In other words, A future contract is one in which one party agrees to buy from/ sell to the other party a specified asset at a price agreed at the time of contract and payable on future date. The agreed price is known as strike price. The underlying asset can be commodity,

currency debt, or equity. The Futures are usually performed by payment of difference between strike price and market price on fixed future date and not by the physical delivery and payment in full on that date.

Features of Future Contract

- An organized exchange.
- Unlike the Forwards, the Future contracts are standardized contracts and are traded on stock exchange.
- It is standardized contract with standard underlying instruments, a standard quantity and quality of the underlying instrument that can be delivered and st and ard time for such settlement transactions.
- Existence of a regulatory authority.
- Margin requirements and daily settlement to act as a safeguard.
- Leveraged positions--only margin required.
- Trading in either direction--short/long
- Index trading.
- Hedging/Arbitrage opportunity.

(C) Options : Options are contracts that give the buyers the right (but not the obligation) to buy or sell a specified quantity of certain underlying assets at a specified price on or before a specified date. On the other hand , the seller is under obligation to perform the contract (buy or sell). The underlying asset can be a share, index, interest rate, bond, rupee-dollar exchange rate, sugar, crude oil, Soya bean, cotton, coffee etc.

Call Option	Put Option
Purchased the right to buy the underlying security	Purchased the right to sell the underlying security
Sold the right to buy the underlying security (might be forced to sell)	Sold the right to sell the underlying security (might be forced to buy)

Call Option : The option that gives the buyer the right to buy is called a call option. A call option grants the holders of the contract the right, but not the obligation, to purchase a good from the writer of the option in consideration for the payment of cash (the option premium).

Put Option : The option that gives the buyer the right to sell is called a put option. A put option grants the holder the right, but not the obligation, to sell the underlying good to the option writer.

Warrants

Options generally have lives of up to one year. The majority of options traded on options exchanges having a maximum maturity of nine months. Longer dated options are called warrants and are generally traded over-the-counter.

LEAPS

The acronym LEAPS means Long-Term Equity Anticipation Securities.

Baskets

Basket options are options on portfolios of underlying assets. The underlying asset is usually a moving average or a basket of assets. Equity index options are a form of basket options.

Swaps

A swap is contract whereby parties agree to exchange obligations that each of them have under their respective underlying contracts or we can say a swap is an agreement between two or more parties to exchange sequence of cash flows over a period in future. The parties that agree to swap are known as counterparties.

The two commonly used swaps are :

Interest Rate Swaps : These entail swapping only the interest related cash flows between the parties in the same currency

Currency Swaps : These entail swapping of both principal and interest between the parties, with the cash flows in one direction, being in a different currency than those in the opposite direction.

Swaptions

Swaptions are options to buy or sell a swap that will become operative at the expiry of the options. Thus a swaption is an option on a forward swap. Rather than have calls and puts, the Swaptions market has receiver Swaption and payer Swaptions. A receiver swaption is an option to receive fixed and pay floating. A payer swaption is an option to pay fixed and receive floating.

Economic Function of the Derivative Market

1. **Prices in an organized derivatives market** reflect the perception of market participants about the future and lead the prices of underlying to the perceived future level. The prices of derivatives converge with the prices of the underlying at the expiration of the derivative contract. Thus derivatives help in discovery of future as well as current prices.
2. **The derivatives market helps** to transfer risks from those who have them but may not like them to those who have an appetite for them.
3. **Derivatives, due to their inherent nature,** are linked to the underlying cash markets. With the introduction of derivatives, the underlying market witnesses higher trading volumes because of participation by more players who would not otherwise participate for lack of an arrangement to transfer risk.
4. **Speculative trades shift** to a more controlled environment of derivatives market. In the absence of an organized derivatives market, speculators trade in the underlying cash markets. Margining, monitoring and surveillance of the activities of various participants become extremely difficult in these kind of mixed markets.
5. **An important incidental benefit** that flows from derivatives trading is that it acts as a catalyst for new entrepreneurial activity. The derivatives have a history of attracting many bright, creative, well-educated people with an entrepreneurial attitude. They often energize others to create new businesses, new products and new employment opportunities, the benefit of which are immense. In a nut shell, derivatives markets help in increase of savings and investment in the long run. Transfer of risk enables market participants to expand their volume of activity.

Derivatives can be classified as :

1. **Commodities Derivatives :** These are derivatives on commodities like sugar, jute, paper, gur, cast or seeds.
2. **Financial Derivatives :** These derivatives deal in shares, currencies and gilt-edged securities.

3. **Basic Derivatives :** Futures and Options are basic derivatives.
4. **Complex Derivatives :** Interest rate futures and swaps are classified as complex derivatives.
5. **Exchange traded derivatives** are standard contracts traded according to the rules and regulations of a stock exchange. Only members can trade in exchange traded derivatives and they are guaranteed against counter-party default. Contracts are settled daily.
6. **OTC** Derivatives are regulated by statutory provisions. Swaps, forward contracts in foreign exchange are usually OTC derivatives and have a high risk of default.

Participants in Derivatives Market

1. **Hedgers** are those who try to minimize loses of both the parties entering into a derivative contract. At the same time, they protect themselves against price changes in the products that they deal in. They use options and futures and hedge in both financial derivatives and commodities derivatives.
2. **Speculators** participate in futures and options. They take high risks for potential gains. Their gains are unlimited but they can take positions and minimize their losses. They trade mainly in futures. They are the major players of the derivatives market.
3. **Arbitrageurs** enter into two transactions into two different stock markets. They are able to make a profit through the difference in price of the asset in different markets. They make a risk less profit but they have to analyze the market with speed to ensure profitability.

Example of Derivative Terms

We suppose that Rakesh wants to buy a house in next year October. At the same time, Mayank has a house worth Rs. 15 Lakh and he plans to sell it in October next year. Since the current price is Rs. 15 Lakh, Mayank and Rakesh enter into an agreement via which Rakesh will buy that house in October 2013 in Rs. 17 Lakh. This would be called a Forward Contract. The price agreed upon would be called **Delivery price.** Since Rakesh is buying it, for him, it would be called **Long Forward Contract.** On the other side, Mayank is selling it; it would be called **Short Forward Contract.**

Now, we suppose that in next year October, instead of Rs. 17 Lakh, the market price of that house becomes Rs. 20 Lakh. Since Mayank is already in contract with Rakesh to sell him the house in Rs. 17 Lakh, Rakesh would earn a profit of Rs. 3 lakh. Mayank would lose Rs. 3 Lakh. Here we note that forward contract is in contrast with the **Spot contract. Spot contract** is an agreement to buy or sell an asset today.

There is one more term related to Forward Contracts called **NDF or Non-Deliverable Forward.** Non-deliverable forwards are over-the-counter transactions settled not by delivery but by exchange of the difference between the contracted rate and some reference rate such as the one fixed by the Reserve Bank of India. For example, if Mayank pays Rakesh Rs. 3 Lakh without delivering the actual house, it would be called NDF. The same is basic funda for commodity forward contracts and currency forward contracts.

1.3 Government Securities Market

A **government** security is a bond or other type of debt obligation that is issued by a **government** with a promise of repayment upon the security's maturity date. **Government** securities are usually considered low-risk investments because they are backed by the taxing power of a **government**.

The main investors in this market, besides the Reserve bank, are the nationalized banks as they have to subscribe these securities to meet their requirements. The additional investors are insurance companies, state government, provident funds, individuals, corporate, non-banking finance companies, primary dealers, financial institutions and to a limited extent, foreign institutional investors and non-resident Indian (NRIs).

Features of Government Securities

- Issued at face value
- No default risk as the securities carry sovereign guarantee.
- Ample liquidity as the investor can sell the security in the secondary market
- Interest payment on a half yearly basis on face value
- No tax deducted at source
- Can be held in D-mat form.

Types of Government Securities

Government Securities are of the following types:-

Dated Government securities

Dated Government securities are long term securities and carry a fixed or floating coupon (interest rate) which is paid on the face value, payable at fixed time periods (usually half-yearly).

Zero Coupon bonds

Zero Coupon bonds are bonds issued at discount on face value and redeemed at par.

Partly Paid Stock

Partly Paid Stock is stock where payment of principal amount is made in installments over a given time frame. It meets the needs of investors with regular flow of funds and the need of Government when it does not need funds immediately.

Floating Rate Bonds

Floating Rate Bonds are securities which do not have a fixed coupon rate. The coupon is re-set at pre-announced intervals (say, every six months or one year) by adding a spread over a base rate.

Capital indexed Bonds

Capital indexed Bonds are bonds where interest rate is a fixed percentage over the wholesale price index. These provide investors with an effective hedge against inflation.

Bonds with Call/Put Option : The bondholder has, in effect, sold a **call option** to the issuer. A puttable **bond** has a **put option** that gives bondholders the right to **"put"** or sell the **bond** before it matures to the issuer when interest rates rise. Another **bond** with an embedded **option** is the convertible **bond**.

These intermediaries have been brought under the regulatory purview and private placement has been made more restrictive.

(a) SEBI registers and regulates the working of mutual funds etc.

(b) SEBI regulates takeover of the companies.

(c) SEBI conducts inquiries and audit of stock exchanges.

(d) Registering and regulating the working of Venture Capital Funds and collective investments schemes including mutual funds.

(e) Promoting and regulating self - regulatory organizations.

(f) Calling for information form, undertaking inspection, conducting inquiries and audits of the stock exchange, mutual funds and intermediaries and self - regulatory organizations in the securities market.

(g) Calling for information and record from any bank or any other authority or boards or corporation established or constituted by or under any Central, State or Provincial Act in respect of any transaction in securities which are under investigation or inquiry by the Board.

(h) SEBI also perform the function of registering and regulating the working of depositories, custodians of securities. Foreign Institutional Investors, credit rating agencies etc.

Powers of SEBI

For the discharge of its functions efficiently, SEBI has been vested with the following powers :

(i) To approve by-laws of stock exchanges.

(ii) To require the stock exchange to amend their by -laws.

(iii) To inspect the books of accounts and call for periodical returns from recognized stock exchanges.

(iv) To inspect the books of accounts of financial intermediaries.

(v) To compel certain companies to list their shares in one or more stock exchanges.

(vi) Registration of brokers.

Role of SEBI in Indian Capital Market

1. **Controlled Stock Exchange :** SEBI control stock Exchange through Rules and Regulation.

2. **To Provide License to Dealer and Broker :** SEBI has power to provide license to dealers and brokers of capital market. If SEBI observe that any financial product is of capital nature, then SEBI can also control to that product and its dealers.

3. **To Stop Fraud in Capital Market :** SEBI can prohibit the trading of those brokers who are involved in fraudulent and unfair trade practices relating to stock market. It can impose the penalties on capital market intermediaries if they involve in insider trading.

4. **Monitor the Workings of Mutual Funds :** SEBI monitors and regulates the working of mutual funds. It keeps a tight supervision on their business operations and protects investors from any unfair practices.

5. **Monitor the Functioning of Intermediaries :** Keeps a tight check on the functioning of the intermediaries like merchant bankers and other intermediaries present in the capital market.

6. **Prohibition of Insider Activity :** It prohibits insider activity and also restricts undesirable practice of brokers and other agents in the capital market.
7. **Conducting Audit :** SEBI uses his powers to audit the performance of different Indian stock exchange for bringing transparency in the working of stock exchanges.
8. **To Make New Rules on Carry – Forward Transactions :** Share trading transactions carry forward cannot exceed 25% of broker's total transactions 90 day limit for carry forward.
9. **Provide Information to Investors :** Time to time, SEBI arranges scheduled workshops to educate the investors. On 22 may 2010 SEBI imposed workshop.Information has passed to various stock exchanges as well as advertised through various national news - papers, broadcast messages through Vividh Bharati and Doordarshan also.
10. **Clearance and Settlement :** Improvements have been made in the clearance and settlement system. A major step in this direction has been the establishment of depositories-NSDL and CDSL- and a clearing corporation-NSCCL.
11. **T + 2 Rolling System :** The SEBI revolutionaries the settlement system by introducing T + 2 rolling settlement system scripts across exchanges. It has issued guidelines for demutualization and corporatization of stock exchanges.
12. **Securities Appellate Tribunal (SAT) :** To create an effective regulatory regime in which all stakeholders have confidence, the SEBI has posted the Securities Appellate Tribunal (SAT) orders on the SEBI website, initiated consultative process for framing regulations, and shortened the inquiry process.

SAT provides a grievance Redressal platform against the SEBI's orders. Public dissemination of such appellate orders is vital as these act as a precedent of other similar cases and on the decision-making process of the SEBI.

Rating Agencies

Rating is an opinion regarding the timely repayment of principal and interest thereon. It is expressed by assigning symbols, which have definite meaning. **Credit rating** is an analysis of the **credit** risks associated with a financial instrument or a financial entity. It is a **rating** given to a particular entity based on the identifications and the extent to which the financial statements of the entity are sound, in terms of borrowing and lending that has been done in the past.

The Indian Rating Agencies are instrumental for the incorporation of Association of Credit Rating Agencies of Asia (ACRAA). The Indian Rating Agencies also provide adequate information to the Investors through their publications.

If two rating agencies give the same security but different ratings, then it is called **split rating;** the few differences that occur are rarely more than one rating grade level apart.

Key areas considered in a rating include the following :

(i) **Business Risk :** To ascertain business risk, the rating agency considers Industry's characteristics, performance and outlook, operating position (capacity, market share, distribution system, marketing network, etc.), technological aspects, business cycles, size and capital intensity.

(ii) **Financial Risk :** To assess financial risk, the rating agency takes into account various aspects of its Financial Management (e.g. capital structure, liquidity position, financial flexibility and cash flow adequacy, profitability, leverage, interest coverage), projections with particular emphasis on the components of cash flow and claims thereon, accounting policies and practices with particular reference for practice of providing depreciation, income recognition, inventory valuation, off-balance sheet claims and liabilities, amortization of intangible assets, foreign currency transactions, etc.

(iii) **Management Evaluation :** Management evaluation includes consideration of the background and history of the issuer, corporate strategy and philosophy, organizational structure, quality of management and management capabilities under stress, personnel policies etc.

(iv) **Business Environmental Analysis :** This includes regulatory environment, operating environment, national economic outlook, areas of special significance to the company, pending litigation, tax status, possibility of default risk under a variety of scenarios.

Credit Rating Agencies in India

Credit Rating Agencies (CRA) assess creditworthiness of organisation and different entities. In simple words, these agencies analyse a debtor's ability to repay the debt and also rate their credit risk. All the credit rating agencies in India are regulated by SEBI (Credit Rating Agencies) Regulations, 1999 of the Securities and Exchange Board of India Act, 1992.

Credit rating agencies assign ratings to an organization or an entity. The entities that are rated by credit rating agencies comprise companies, state governments, non-profit organisations, countries, securities, special purpose entities, and local governmental bodies. Credit rating agencies take into consideration several factors like the financial statements, level and type of debt, lending and borrowing history, ability to repay the debt, and the past debts of the entity before rating their credit. Once a credit rating agency rates the entities, it provides additional inputs to the investor following which the investor analyses and takes a sound investment decision. Poor credit rating indicates that the entity is at a high risk of defaulting. The credit ratings that are given to the entities serve as a benchmark for financial market regulations. Credit ratings are published by agencies like Moody's Investors Service and Standard and Poor's (S&P) based detailed analysis.

There are total six credit agencies in India

1. CRISIL (Credit Rating Information Services of India Limited)
2 ICRA (Investment Information and Credit Rating Agency of India
3. CARE (Credit Analysis and Research limited)
4. SMREA
5. Brickwork Rating
6. India Rating and Research Pvt. Ltd.

1. Credit Rating Information Services of India Limited (CRISIL)

CRISIL is one of the oldest credit rating agencies in India. It was launched in the country in 1987 following which the company went public in 1993. Headquartered in Mumbai, CRISIL ventured into infrastructure rating in 2016 and completed 30 years in 2017. CRISIL acquired

8.9% stake in CARE credit rating agency in 2017. It launched India's first index to benchmark performance of investments of foreign portfolio investors (FPI) in the fixed-income market, in the rupee as well as dollar version in 2018. The company's portfolio includes, mutual funds ranking, Unit Linked Insurance Plans (ULIP) rankings, CRISIL coalition index and so on.

2. ICRA Limited

ICRA Limited is a public limited company that was set up in 1991 in Gurugram. The company was formerly known as Investment Information and Credit Rating Agency of India Limited. Before going public in April 2007, ICRA was a joint venture between Moody's and several Indian financial and banking service organisations. The ICRA Group currently has four subsidiaries - Consulting and Analytics, Data Services and KPO, ICRA Lanka and ICRA Nepal. At present, Moody's Investors Service, the international Credit Rating Agency, is ICRA's largest shareholder. ICRA's product portfolio includes rating for - corporate debt, financial rating, structured finance, infrastructure, insurance, mutual funds, project and public finance, SME, market linked debentures and so on.

3. Credit Analysis and Research limited (CARE)

Launched in 1993, CARE offers credit rating services to areas such as corporate governance, debt ratings, financial sector, bank loan ratings, issuer ratings, recovery ratings, and infrastructure ratings. Headquartered in Mumbai, CARE offers two different categories of bank loan ratings, long-term and short-term debt instruments. The company also offers ratings for Initial Public Offerings (IPOs), real estate, renewable energy service companies (RESCO), financial assessment of shipyards, Energy service companies (ESCO) grades various courses of educational institutions. CARE Ratings has also ventured into valuation services and offers valuation of equity, debt instruments, and market linked debentures. Moreover, the company has launched a new international credit rating agency 'ARC Ratings' by teaming up with four partners from South Africa Brazil, Portugal, and Malaysia. ARC Ratings has commenced operations and completed sovereign ratings of countries, including India.

4. Small and Medium Enterprises Rating Agency of India (SMERA)

Established in 2005, SMERA is a joint initiative of SIDBI, Dun & Bradstreet India and leading banks in India. SMERA has joined hands with prominent institutions such as IIT Madras, The Bangladesh Rating Agency Limited, CAFRAL, CoinTribe, and SIES. Apart from its shareholder banks, SMERA has also entered into MoUs with over 30 Banks, Financial Institutions and Trade Associations of the country.

5. Brickwork Ratings (BWR)

Brickwork Rating was established in 2007 and is promoted by Canara Bank. It offers ratings for bank loans, SMEs, corporate governance rating, municipal corporation, capital market instrument, and financial institutions. It also grades NGOs, tourism, IPOs, real estate investments, hospitals, IREDA, educational institutions, MFI, and MNRE. Brickwork Ratings is recognised as external credit assessment agency (ECAI) by Reserve Bank of India (RBI) to carry out credit ratings in India.

6. India Rating and Research Pvt. Ltd.

India Ratings is a wholly-owned subsidiary of the Fitch Group. It offers credit ratings for insurance companies, banks, corporate issuers, project finance, financial institutions, finance and leasing companies, managed funds, and urban local bodies. In addition to SEBI, the company is recognised by the Reserve Bank of India and National Housing Bank.

ADR (American Depositary Receipts) and GDR (Global Depositary Receipts)

These are commonly known as Depository Receipts ('DR'), a negotiable security issued outside India by a depository bank ('DB'), on behalf of the Indian company, which reflects the local rupee denominated equity shares of the company held as deposit by a custodian bank ('CB') in India. These DR's were bought out as an option for Indian companies to get an access to overseas capital markets.

American Depositary Receipt (ADR)

American Depositary Receipts have been introduced to the financial markets as early as April 29, 1927, when the investment bank J. P. Morgan launched the first-ever ADR program for the UK's Selfridges Provincial Stores Limited (now known as Selfridges plc.), a famous British retailer.

American Depository Receipt (ADR) is a certified negotiable instrument issued by an American bank suggesting the number of shares of a foreign company that can be traded in U.S. financial markets.

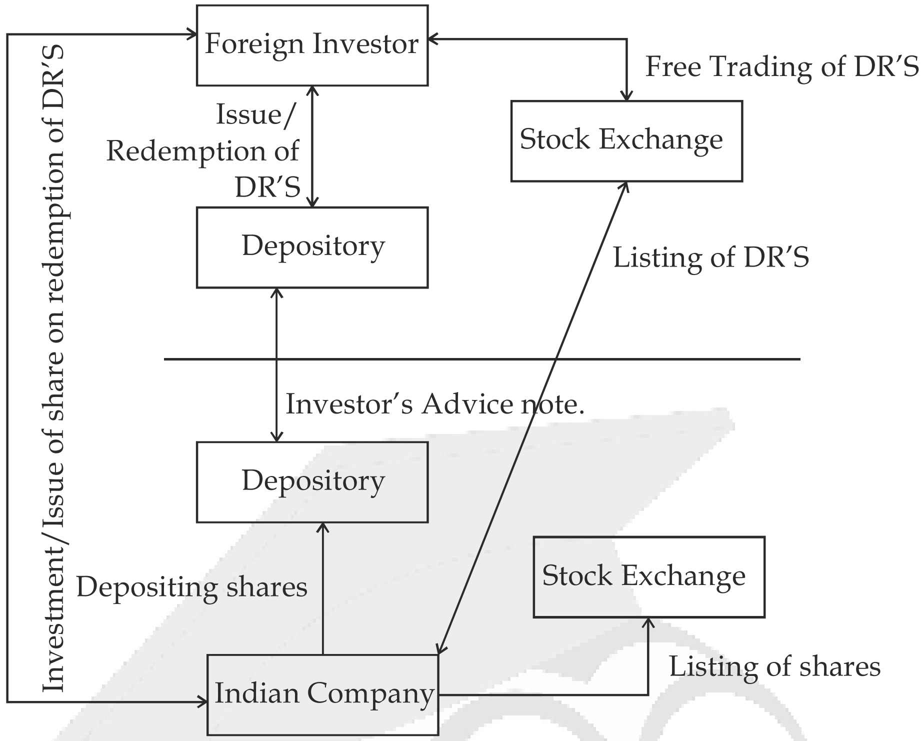
American Depository Receipts provide US investors with an opportunity to trade in shares of a foreign company. When the ADRs did not exist, it was very difficult for an American investor to trade in shares of foreign companies as they had to go through many rules and regulation.

To ease such hardship faced by American investors, the regulatory body Securities Exchange Commission (SEC) introduced the concept of ADR which made it easier for an American investor to trade in shares of foreign companies. American depository receipt fee varies from one cent to three cents per share depending upon the ADR amount and its timing.

Process of ADR's

- The domestic company, already listed in its local stock exchange, sells its shares in bulk to a U.S. bank to get itself listed on U.S. exchange.
- The U.S. bank accepts the shares of the issuing company. The bank keeps the shares in its security and issues certificates (ADRs) to the interested investors through the exchange.
- Investors set the price of the ADRs through bidding process in U.S. dollars. The buying and selling in ADR shares by the investors is possible only after the major U.S. stock exchange lists the bank certificates for trading.
- The U.S. stock exchange is regulated by Securities Exchange Commission, which keeps a check on necessary compliances that need to be complied by the foreign company.

Overseas



ADR programs, or "facilities," are typically classified under three levels :

1. When an ADR program is established based on existing ordinary shares and traded in the U.S. OTC market, it is categorized as a "Level I" ADR facility.
2. When such a program is listed on one of the above-mentioned U.S. stock exchanges, with no corresponding offering of newly issued shares or ADRs, it is identified as a "Level II" ADR facility.
3. When an ADR program facilitates a capital raising, accommodating newly issued ordinary shares, and is listed on a U.S. national stock exchange, it is identified as a "Level III" ADR facility.

Global Depositary Receipts (GDR)

A Global Depositary Receipt (GDR) is a negotiable instrument issued by a depositary bank in international markets – typically in Europe and generally made available to institutional investors both outside and within the U.S. – that evidences ownership of shares in a non-U.S. company, enabling the company (issuer) to access investors in capital markets outside its home country.

GDRs are usually offered to institutional investors through a private offering, in reliance on exemptions from registration under the Securities Act of 1933.

The predominant listing venues for Reg. S GDRs are the **London and Luxembourg Stock Exchanges,** with GDRs having also been listed on the Singapore Exchange, Frankfurt Stock Exchange and Nasdaq Dubai. Rule 144A GDRs trade in the U.S. over-the-counter market.

Following are the main features of GDR :

(i) It represents certain number of equity shares denominated in dollar terms.

(ii) The issuer collects the issue proceeds in foreign currency.

(iii) It is traded on the stock exchanges of Europe and USA.

(iv) Through the issue of GDR, funds can be raised from the foreign capital market of USA and Europe.

(v) The issuer company deposits all the shares intended to issue with an intermediary called 'depository' located in the country where it wants to list the shares. The depository issues receipts against these shares, each receipt is having a fixed number of shares usually 2 or 4.

Then equity shares registered in the name of depository are issued in the form of GDR to the investors of the foreign country by the respective depository.

(vi) The shares issued to the depository are kept in physical possession of another intermediary called 'custodian'. The custodian acts as an agent of the depository.

(vii) The GDR does not appear in the books of the issuing company.

(viii) GDR does not carry any exchange risk because each GDR is also denominated in rupees at the time of issue. Hence, its face value is protected against the exchange risk.

(ix) GDR are listed at Luxembourg and traded at two other stock exchanges namely, the OTC market in London and in USA by private placement.

(x) The GDR does not carry any voting right.

(xi) The issue of GDR is governed by international laws.

(xii) Non Resident Indians and foreign residents can buy the GDR by using their regular share trading account.

Ques. *Match the items of List-I with the items in List-II and suggest the correct code :*

(NTA UGC NET July 2016 P-II)

	List-I		***List-II***
(a)	*Interbank call market*	*(i)*	*Money market*
(b)	*Commercial Bills*	*(ii)*	*Promissory note*
(c)	*Commercial paper market*	*(iii)*	*Short-term maturity*
(d)	*Treasury bills*	*(iv)*	*Government papers*

Codes :

	(a)	***(b)***	***(c)***	***(d)***
(1)	*(i)*	*(ii)*	*(iv)*	*(iii)*
(2)	*(iii)*	*(i)*	*(ii)*	*(iv)*
(3)	*(i)*	*(iii)*	*(iv)*	*(ii)*
(4)	*(iv)*	*(iii)*	*(ii)*	*(i)*

Ans. *(2)*

	List-I		***List-II***
(a)	*Interbank call market*	*(i)*	*Short term Maturity*
(b)	*Commercial Bills*	*(ii)*	*Money market*
(c)	*Commercial paper market*	*(iii)*	*Promissory note*
(d)	*Treasury bills*	*(iv)*	*Government papers*

Ques. *Which of the following are the instruments of money market ?*

(NTA UGC NET July 2016 P-III)

(i) Call money market *(ii) Commercial bill market*

(iii) Industrial securities market *(iv) Short-term securities market*

(v) Treasury bill market

Codes :

(1) (i), (ii), (iv), (v) *(2) (i), (ii), (v)*

(3) (i), (ii), (iii), (iv), (v) *(4) (i), (ii), (iii), (iv)*

Ans. *(1)*
(i) Call money market
(ii) Commercial bill market
(iv) Short-term securities market
(v) Treasury bill market

Ques. *Which of the following is not a feature of OTCEI ?* **(NTA UGC NET July 2016 P-III)**

(1) Quick transfer and disposal system

(2) Nationalised computerised networking

(3) Ringless trading system

(4) Fragmentation of regional stock exchanges

Ans. *(4) Fragmentation of regional stock exchanges*

Features of OTCEI

1. *Nationwide trading*
2. *Ringless trading*
3. *Compulsory investor registration*
4. *Transparent trading*
5. *Transfer by counter-receipt*
6. *Only authorised dealers*

Ques. *The world's first electronic stock market is :* **(NTA UGC NET June 2015 P-II)**

(A) KOSPI *(B) Nikkie*

(C) NASDAQ *(D) Dow Jones*

Ans. *(C) The Nasdaq Stock Market is a world famous stock market, based in the US. Nasdaq uses computer and telecommunications networks to trade and monitor thousands of listed stocks, sometimes also referred to as securities.*

It was the first stock market in the world to trade electronically, as opposed to people dealing from a trading floor in a physical location.

Ques. *In order to control inflation and ensure stability in money market :*

(NTA UGC NET June 2015 P-II)

(A) The RBI works under the direction of ministry of finance, government of India.

(B) The RBI acts independently and can refuse the government directive.

(C) The RBI acts under the board of directors.

(D) The RBI's board of governors shall abide by the government directive.

Ans. *(B) In order to control inflation and ensure stability in money market the RBI acts independently and can refuse the government directive.*

Ques. *The instrument chosen for enhancement of international liquidity is :*

(NTA UGC NET June 2015 P-II)

(A) Society for World wide Inter bank Financial Telecommunications (SWIFT)

(B) Special Drawing Rights (SDRs)

(C) Multilateral Netting

(D) Netting of Payments

Ans. *(B) The instrument chosen for enhancement of international liquidity is Special Drawing Rights (SDRs).*